

# The Directive on the Credit Agreements for Consumers relating to Residential Immovable Property (Directive 2014/17): a Regulatory Explanation and a Private Law Analysis

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# The Directive on the Credit Agreements for Consumers relating to Residential Immovable Property (Directive 2014/17): a Regulatory Explanation and a Private Law Analysis.

## Abstract

With the devastation wrought by the 2008 ‘property market bubble’ still fresh in the mind on one hand, and a spate of recent enthusiasm manifested in the ‘rush to the property ladder’ on the other, the newly enacted Directive 2014/17 seeks to strike a middle ground of reasonableness in the delicate and sensitive matter of the security granted by the buyer of a residential property.

Against this background, the present contribution analyses, first and foremost, the norms of a regulatory nature introduced by the new EU piece of legislation and the attempt to shape a new category of consumer. Among these precepts, attention is particularly afforded to the principle, of a public nature, prescribing that the bank’s assessment to grant a mortgage shall be prevalently based on the ability of the mortgagor to repay the debt, rather than on the expected (but undemonstrated) burgeoning future value of the property.

Furthermore, the discussion focuses on the private law principles introduced by the Directive. Among these is the onus lying on the bank to provide adequate information about the terms and conditions of the mortgage. More interestingly, the directive at stake derogates from, and goes beyond, the notion of prohibition of ‘agreement of forfeiture’ existing in some civil law jurisdictions. This novelty, the ancillary legal provisions of art 28 of Directive 2014/17 as well as their impact on the system of civil proceedings and foreclosure existing in each country, provide fertile ground for a legal and comparative analysis.

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## 1. Introduction

The financial sector has proved a particularly harsh domain over much of the past decade. Prior to 2007, many property buyers had availed of readily accessible loans, nonchalantly granted by credit institutions, on the widely-held assumption that the underlying good (the property) would perpetually rise in value. In reality, from 2008 the property market veered significantly in the opposite direction, with falling prices pushing buyers inexorably towards a ‘negative equity’<sup>1</sup>. However, this downward spiral has since been arrested and an upward curve re-established as the value of the properties has more recently started climbing again, in some countries to levels which even surpass those recorded in the pre-crisis era.<sup>2</sup> This may indicate that the common theories surrounding the property market, disseminated with confidence prior to 2008 (*ergo*, the property market as a relentlessly thriving entity), were not entirely without merit, at least when assessed from a long-term perspective.<sup>3</sup>

Aside from these economic considerations and the inevitable puzzles that they engender, a concern of a more legal nature arises in connection with the purchase of a property burdened by a mortgage. The mortgagor buys a property and this formally belongs to the borrower. In reality, if the latter was not in a position to maintain the agreed repayment plan in the form of instalments, usually encompassing both the capital and interest, the lender is entitled to repossess the property, thereby evicting the mortgagor from his investment.<sup>4</sup>

Contemplated from within the context of this complex set of circumstances, the ‘credulous’ consumer jumping unwittingly onto ‘the property ladder’ has become a matter of grave concern, also in the eyes of the EU legislator. A new piece of legislation, Directive 2014/17 (‘Mortgage Credit Directive’ or ‘MCD’) has been passed on 4 February 2014,<sup>5</sup> to react to and address the adverse

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<sup>1</sup> To elaborate historically the events occurred, property buyers, who had purchased their ‘good’ at the pick of the market, were forced in the medium term to pay for an underlying property that, in reality, did not reflect any longer the original value.

<sup>2</sup> Britain would be an example of this positive performance. See The Guardian, ‘Average UK Flat Value Rises 60% in Past Decade’ (23 September 2015) <<http://www.theguardian.com/money/2015/sep/23/average-uk-flat-value-rises-60-per-cent-past-decade>> accessed 25 September 2015.

<sup>3</sup> G Matysiak and P Wang, ‘Commercial Property Market Prices and Valuations: Analysing the Correspondence’ (1995)12 Journal of Property Research 181-2002.

<sup>4</sup> In Section 8 below, a discussion on the consequences of these legal provisions of a civil proceeding nature on the main legal systems in the EU (the common law and the civil law ones) is provided.

<sup>5</sup> Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010. (OJ L60). The Directive entered into force on 20 March 2014, on the twentieth day following its publication on the Official Gazette of the European Union. Such a publication has occurred on 28 February 2014. The Directive is applicable to EEA countries too.

consequences that stem from ‘irresponsible lending and borrowing and the potential scope for irresponsible behaviour by market-participants including credit intermediaries and non-credit institutions.’<sup>6</sup>

The transposition of this Directive is not immediate.<sup>7</sup> According to art 42(1) of the Mortgage Credit Directive, each Member State ‘shall adopt and publish, by 21 March 2016, the laws, regulations and administrative provisions necessary to comply with the Directive.’ This precept is accompanied by an obligation on the Member State to ‘communicate to the Commission the text of those measures.’<sup>8</sup> However, the Directive shall not apply to credit agreements which were in effect prior to 21 March 2016,<sup>9</sup> irrespective of when it becomes incorporated within the domestic legislation of each country. Accordingly, the legal provisions encompassed therewith have taken effect concurrently across the Union on 21 March 2016. In other words, regardless of how swiftly a country implements the Directive, the date from which it has taken effect has not been earlier, nor later, than 21 March 2016.

An example of swift implementation of the aforementioned Directive is evident in the case of Britain, where the EU piece of legislation under discussion has been transposed in force of the Mortgage Credit Directive Order 2015 (SI 2015/910). This has amended current British legislation on the matter at hand, particularly the Financial Markets and Services Act 2000. Incidentally, the British Government has decided not to pursue the alternate ‘copy-out’ option in the transposition of the directive at stake. This would have directed the UK legislature to abolish the rules of protection of the mortgage consumer already enshrined within the FMSA 2000 and, as a consequence, created uncertainty for the prospective buyers.<sup>10</sup>

## **2. The Mortgage Credit Directive and its main principles**

As to the merit of the specific legal provisions, the statute at stake stipulates that, although each Member State is not prevented ‘from maintaining or introducing more stringent provisions in order to protect consumers’,<sup>11</sup> a more robust support platform shall be provided to the benefit of the consumer by each jurisdiction as a means to establishing a more responsible outlook to borrowing and debt management, ‘in particular in relation to mortgage credit agreements’.<sup>12</sup>

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<sup>6</sup> See Recital 4 of Directive 2014/17.

<sup>7</sup> According to art. 42, Directive 2014/17, Member State ‘shall adopt and publish, by 21 March 2016, the law and regulations and administrative provisions necessary to comply with the Directive.’

<sup>8</sup> Article 42(3) of Directive 2014/17.

<sup>9</sup> Article 43(1) of Directive 2014/17.

<sup>10</sup> See HM Treasury, ‘The Implementation of the Mortgage Credit Directive. Summary of Responses’ (January 2015, [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/397904/implementation\\_of\\_the\\_EU\\_MCD\\_summary\\_of\\_responses.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/397904/implementation_of_the_EU_MCD_summary_of_responses.pdf)) accessed 15 September 2015.

<sup>11</sup> Article 2(1) of Directive 2014/17.

<sup>12</sup> Ibid., article 6(1).

Fundamentally, there are two pillars on which the MCD rests. First, the new piece of legislation aims to create minimum regulatory requirements, addressed to Member States, the purpose of which is to safeguard a consumer seeking to take out credit agreements relating to residential properties. This purpose of Directive 2014/17 has been questioned in its essence by some countries, particularly Britain. The UK Government has drawn attention to the fact that its legislature had already fashioned ‘a robust regulatory regime to protect consumers engaged in the first residential mortgage market.’<sup>13</sup> This assertion will be verified within the confines of Section 8 below, specifically under the subsection dealing with foreclosure proceedings and art 28 of Directive 2014/17.

Second, this EU statute should facilitate a more competent internal market of mortgage lending across Europe, in accordance with the Treaty of the Functioning of the European Union. Irrespective of whether or not these assumptions are factually corroborated, a more transparent and efficient market in this area ‘is vital in promoting the development of cross-border activity and creating an internal market for credit agreements relating to residential immovable property.’<sup>14</sup> In this respect, it has been counterclaimed by some countries<sup>15</sup> that the MCD would not remove the primary obstacles of the internal market, viz. the lender’s difficulty ‘in understanding unfamiliar markets and the complexity in enforcing loans under foreign legal systems.’<sup>16</sup>

From a regulatory point of view, the MCD designates an authority to oversee the application of the novel piece of legislation.<sup>17</sup> This power shall ensure that the designated authorities ‘are granted investigating and enforcement powers and adequate resources necessary for the efficient and effective performance of these duties.’<sup>18</sup> The power to designate such an authority is vested with each Member State. Nevertheless, the eligible body shall be a public authority, or a body recognised by national law or a public authority ‘expressly empowered for that purposes by national law.’<sup>19</sup> Notwithstanding the discretion left to each Member State in such a decision, under no circumstances shall such an authority embody creditors, credit intermediaries or appointed representatives and/or relevant

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<sup>13</sup> See HM Treasury, ‘The Implementation of the Mortgage Credit Directive. Summary of Responses’ (January 2015,

p 3) <  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/397904/implementation\\_of\\_the\\_EU\\_MCD\\_summary\\_of\\_responses.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/397904/implementation_of_the_EU_MCD_summary_of_responses.pdf)>  
 accessed 15 September 2015.

<sup>14</sup> Recital 2 of the MCD.

<sup>15</sup> The British Government, in the run-up to the domestic implementation of the DCD, seems to be very sceptical and dubious about the two *rationes essendi* of the MCD.

<sup>16</sup> See HM Treasury, ‘The Implementation of the Mortgage Credit Directive. Summary of Responses’ (January 2015,

p 3) <  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/397904/implementation\\_of\\_the\\_EU\\_MCD\\_summary\\_of\\_responses.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/397904/implementation_of_the_EU_MCD_summary_of_responses.pdf)>  
 accessed 15 September 2015.

<sup>17</sup> MCD, art 5(1).

<sup>18</sup> *Ibid.*

<sup>19</sup> Art 5(1).

associations. The obvious reason for this is to negate the potential that any conflict of interest may arise.<sup>20</sup>

In Italy, for instance, this role shall be given to the *Banca d'Italia*, the Italian central Bank that is in charge of both the functions, the assessment of the stability of the financial institutions and the prudent conduct vis-a-vis the clientele.<sup>21</sup> Conversely, in Britain, this role has been assigned to the Prudential Regulation Authority, the authority charged with safeguarding the consumer against any form of exploitation perpetrated by credit institutions whilst offering their products. In critically assessing the new norms, it can be affirmed that, in cases where, like in Britain, the supervision is a twin-peak one,<sup>22</sup> the manner in which the Directive is drafted is not conducive to the level of consistency and effectiveness that it could, or should, demonstrate.<sup>23</sup> As highlighted during the 2008/2009 financial crisis, the intermediaries' reckless conduct in too nonchalantly granting mortgages may eventually have a detrimental impact on the same stability of the creditors. Therefore, Directive 2014/17 should have clearly imposed a mandatory role to be held by the national authority in connection with the two supervisory purposes (both stability of the credit institution and transparent conduct ascribable to it).

Regardless of the authority appointed, the MCD states in no uncertain terms that 'all persons who work or who have worked for the competent authorities, as well as auditors and experts instructed by the competent authorities, are bound by the obligation of professional secrecy.'<sup>24</sup>

### **3. A legal analysis of the Mortgage Credit Directive**

#### **3.1. The area of applicability**

The Consumer Credit Directive ('CCD')<sup>25</sup> had already shaped, at EU level, a new category of consumer. The relevant contracts to which this legislation applies are credit contracts with consumers. In the aforementioned Directive, the definition of consumer is reminiscent of that inferred under the general rules of the Unfair Terms Directive ('UTD').<sup>26</sup> Thus, the consumer is 'the natural person who, in transactions covered by this Directive, is acting for purposes which are outside his trade, business or profession'.<sup>27</sup> Remarkably, the transactions falling within the ambit of the CCD are credit agreements. More specifically, a credit agreement is 'an agreement whereby a creditor grants or promises to grant to a consumer credit in the form of a deferred payment, loan or other similar financial

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<sup>20</sup> Art 5(2), MCD.

<sup>21</sup> Article 2 of the Legislative Decree no 385 of 1<sup>st</sup> September 1993 (the Italian Banking Act).

<sup>22</sup> The Prudential Regulation Authority in charge of the conduct of the intermediaries vis-à-vis the public and the Financial Policy Committee deputed to supervise the stability of credit institutions.

<sup>23</sup> Nevertheless, it may be arduous to say that across the Channel there is an actual infringement of the MCD as regards the way it has been implemented.

<sup>24</sup> Art 5(2), MCD.

<sup>25</sup> Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC (OJ L 133).

<sup>26</sup> Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (OJ L095).

<sup>27</sup> Article 3(a) of the Consumer Credit Directive.

accommodation, ... , where the consumer pays for such services or goods for the duration of their provision by means of instalments.’<sup>28</sup> It is a well-known fact that the category of the consumer credit agreement does not encompass, by way of an express exclusion of the EU legislature, credit agreements ‘involving a total amount of credit less than Euro 200 or more than Euro 75.000’.

Against this background, an individual asking a bank for a credit relating to the purchase of a residential property is a further category of consumer which the recent piece of legislation, Directive 2014/17, has expressly acknowledged. In practical terms, this is the person who, for himself or on behalf of his family, lodges an application with a lender, typically in the form of a credit institution, for a loan. The ultimate purpose of the application is to buy a property, with a specific guarantee (security or mortgage) provided by the client (the borrower) on the acquired property and given to the benefit of the lender.

Article 1 of Directive 2014/17 clarifies the ambit of applicability of the new piece of legislation. The categories of contract fall into two mainly areas. The first one relates to credit agreements ‘which are secured either by a mortgage or by another comparable security commonly used in a Member State on residential immovable property or secured by a right related to residential immovable property ...’.<sup>29</sup> Because the MCD does not distinguish between first and second charge mortgage, it is implied that the latter credit agreements too are subject to the new rules.<sup>30</sup> A further category caters for credit agreements ‘the purpose of which is to acquire or retain property rights in land or in an existing or projected building.’<sup>31</sup>

### 3.2. Exempt transactions

Not all mortgages fall within the perimeter of Directive 2014/17. Article 3(2) of the Mortgage Credit Directive exempts from the boundaries of the new legislation some significant transactions. These exemptions are mandatory. In other words, Member States have no option but to implement such an exemption in their respective national legal frameworks.

First and foremost, equity release credit agreements are not included within the transaction to which the MCD applies.<sup>32</sup> These are agreements occurring when two concurrent conditions are met: on the one hand, the creditor ‘contributes a lump sum, periodic payments or other forms of credit disbursement in return for a sum deriving from the future sale of a residential immovable property or a right relating to residential immovable property’; on the other hand, the creditor ‘will

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<sup>28</sup> Ibid., art 3(c).

<sup>29</sup> Articles 3(1)(a) of the Mortgage Credit Directive.

<sup>30</sup> This interpretation is supported by the same authorities. See, in Britain, the Financial Conduct Authority. FCA, ‘Mortgage Credit Directive’ (13 March 2015) < <https://www.fca.org.uk/firms/firm-types/mortgage-brokers-and-home-finance-lenders/mcd> > accessed 16 September 2015.

On such a ground, the British Government has decided that second charge mortgage regulation should move from the FCA's consumer credit regime into the FCA mortgage regime. This means that, to carry on second charge mortgage business after 21 March 2016, lenders, administrators and brokers have to be authorised and hold the correct mortgage permissions.

<sup>31</sup> Article 3(1)(b) of the Mortgage Credit Directive.

<sup>32</sup> Ibid., art 3(2)(a).

not seek repayment of the credit until the occurrence of one or more specified life events of the consumer, ..., unless the consumer breaches his contractual obligations which allows the creditor to terminate the credit agreement.’

Additionally, the generous loan afforded by the employer, as a secondary activity, to its employee whereby the latter may buy a property, is also exempt, so long as this credit agreement ‘is offered free of interest or at an APRC lower than those prevailing on the market and not offered to the public generally.’<sup>33</sup>

Further categories of exempt mortgages are: ‘credit agreements where the credit is granted free of interest and without any other charges except those that recover costs directly related to the securing of the credit’;<sup>34</sup> ‘credit agreements in the form of an overdraft facility and where the credit has to be repaid within one month’;<sup>35</sup> ‘credit agreements which are the outcome of a settlement reached in court or before another statutory authority’;<sup>36</sup> ‘credit agreements which relate to the deferred payment, free of charge, of an existing debt ...’<sup>37</sup>

In addition to these mortgages that are excluded on a mandatory basis, the MCD refers to further mortgages that can be excluded at the discretion of each Member State. These categories are basically those contemplated at article 3(3)(a), 3(3)(b), 3(3)(c), 3(3)(d), 3(3)(e), in respect of which the decision rests exclusively with the Member State as to whether or not to apply the new rules of the Directive. The *caveat* in this case is that a Member State which decides not to apply the Directive shall put in place an ‘appropriate framework at a national level for this type of credit.’<sup>38</sup>

Among these categories, it is worth drawing attention to art 3(3)(b) of Directive 2014/17. The legal provision refers to credit agreements concerned with an immovable property that ‘cannot at any time be occupied as a house, apartment or another place of residence by the consumer or a family member of the consumer and is to be occupied as a house, apartment or another place of residence on the basis of a rental agreement.’<sup>39</sup> In simpler terms, this refers to the buy-to-let mortgage,<sup>40</sup> properties bought by an investor in order to let it out.

Among the different Member States, Britain is the sole country that has decided to exercise its right to exemption in relation to these transactions.<sup>41</sup> Yet, as far as the same concept of buy-to-let mortgage is concerned, the UK definition of this kind of mortgage used to be decidedly ‘loose’. In detail, it was extended also to circumstances where at least 60% of the property was let out. In other words, so long as no more than 40% of the property was occupied by the borrower or the

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<sup>33</sup> Ibid., art 3(2)(b).

<sup>34</sup> Ibid., art 3(2)(c).

<sup>35</sup> Ibid., article 3(2)(d).

<sup>36</sup> Ibid., art 3(2) (e).

<sup>37</sup> Ibid., art 3(2)f.

<sup>38</sup> Article 3(4) of the MCD.

<sup>39</sup> Ibid., art 3(3)(b).

<sup>40</sup> From a commercial point of observation of this niche property sub-area, see A Leyshon and S French, ‘ “We All Live in a Robbie Fowler House”: the Geographies of the Buy to Let Market in the UK’ (2009)11 The British Journal of Politics & International Relations 438-460.

<sup>41</sup> See Explanatory Memorandum to the Mortgage Credit Directive Order 2015 2015 No. 910.



family member, the relevant mortgage lending could have been excluded, as falling within the category of buy-to-let mortgages. As a result of the legal provisions of the MCD, this British approach has required a change to the domestic legislation, given that it is no longer consistent with the new framework implemented last March 2016.<sup>42</sup>

#### **4. The general rules applicable to those offering and/or brokering mortgages**

The mortgage is not simply a banking product but, given the current dimensions of the market behind it, is an actual industry in itself. It follows from this that multifarious activities are implied in the relevant process, ranging from the advisory activity to the signing of the contract.

First, a mortgage, as a credit product, can be manufactured by a bank or other market players. Additionally, the same product can be marketed, by the same bank but also by intermediaries. Finally, an advisory activity can be provided to the market in connection with a mortgage. In all these scenarios, the overriding principle is that the creditor, the credit intermediary or the appointed representative, must adhere to a need to act ‘honestly, fairly, transparently and professionally, taking into account the interests of the consumers.’<sup>43</sup>

Remarkably, those subject to these rules of conduct are not simply the creditors, but also the credit intermediaries and the appointed representatives. As regards the ‘creditor’, the Directive under discussion opts for a particularly broad definition: ‘a natural or legal person who grants or promises to grant credit falling within the scope of Article 3 in the course of his trade, business or profession.’<sup>44</sup> The legal provision, therefore, is more extensive than expected, as it encompasses not simply the traditional bank (the lender by definition, the mortgagee who is the beneficiary of the mortgage) but also any other individual or, as is more likely, legal entity engaged in that business.

The ‘credit intermediary’ is defined as a natural or legal person who ‘presents or offers credit agreements to consumers’, or ‘assists consumers by undertaking preparatory work or other pre-contractual administration in respect of credit agreements ...’, or ‘concludes credit agreements with consumers on behalf of the creditor’.<sup>45</sup>

Finally, the ‘appointed representative’ is the ‘natural or legal person who performs [core and ancillary activities connected with mortgages] that is acting

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<sup>42</sup> See what predicted in advance by the same authorities. HM Treasury, ‘Implementation of the EU Mortgage Credit Directive: Summary of Responses’ (January 2015, 10) <<https://www.gov.uk/government/consultations/implementation-of-the-eu-mortgage-credit-directive>> accessed 16 September 2015.

<sup>43</sup> Directive 2014/17, Article 7(1). See M Haentjens and P de Gioia-Carabellese, *European Banking and Financial Law* (Routledge 2015) 71.

<sup>44</sup> Directive 2014/17, art 4(2).

<sup>45</sup> *Ibid.*, art 4(5).

on behalf of and under the full and unconditional responsibility of only one credit intermediary.’<sup>46</sup>

## **5. Rules of conduct for those engaged in the mortgage market: general information; pre-contractual information: the creditworthiness**

More stringent rules are imposed on lenders in respect to the way they conduct their business in this delicate market. In this respect, the piece of EU legislation rests on three fundamental pillars.

### **5.1. General information**

The ‘macro-rules’ established by Directive 2014/17 relate to the general information administered to the public, in cases where credit agreements were offered to the market.

In this respect, two legal provisions are worth acknowledging.

Firstly, the manner in which credit agreements are advertised to the public (art. 11) is crucial. In this respect, any advertising concerning credit agreements of this kind shall refer, on a mandatory basis, to ‘an interest rate or any figures relating to the cost of the credit’ (art. 11(1)).

Secondly, art. 13 of Directive 2014/17 stipulates that each Member State shall ensure that any communication ‘on paper or on other durable medium or on electronic form’ is ‘clear and comprehensible’. This obligation shall be complied with not simply by the creditors, but also by ‘tied credit intermediaries’ and their ‘appointed representatives.’

### **5.2. Pre-contractual information**

An additional set of rules enshrined within Directive 2014/17 are those relating to the contracts. Although the arena of contract law is traditionally deemed a ‘national’ one, *ergo* reserved to the discretion of each Member State as it is considered the realm of private or commercial law, the Directive does not refrain from dictating some noteworthy rules relating to the requirements for pre-contractual information. According to Directive 2014/17, art 14, the creditor, pursuant to the specific legal provisions that each Member State is under an obligation to implement by March 2016, shall provide the consumer with ‘personalised information needed to compare the credits available on the market, assess their implication and make an informed decision on whether to conclude a credit agreement’. This information is specified as ‘pre-contractual’: it precedes the conclusion of the contract or, to use the terminology of the legislator, is to be made available ‘in good time before the consumer is bound by any credit agreement or offer.’

Similarly, the creditor, according to article 16 of Directive 2014/17, is under an obligation of provide ‘adequate explanations’ to the consumer ‘on the proposed credit agreements and any ancillary services’. The concept of ancillary services

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<sup>46</sup> Ibid., art 4(8).

is not clarified in terms of its boundaries. This expression, which is not within the definitions of CMD, may encompass any product, whether of a financial nature or not and irrespective of whether or not it was issued by the same lender, where a causal link can be established with the subscription of the credit agreement.<sup>47</sup> In this respect, the terminology adopted by the EU legislator, in the English version of Directive 2014/17, is probably not without its flaws. In the context of the new piece of legislation, what is considered ancillary should include also products connected with the mortgage, viz. an insurance policy. Therefore, in order to give a sense to the legislation, service should be interpreted as broadly as is possible to include services and products; otherwise, the area of applicability of the term would be too limited.

### 5.3.Credit worthiness

Regardless of the nature of the ancillary services, the general goal of the ‘adequate explanation’ at stake is to ensure that the credit agreement proposed to the client and the ancillary product is ‘adapted to his needs and financial situation’.

The degree of creditworthiness displayed by the client is an additional matter of concern in the mortgage market. Art 18 of the directive under discussion deals with this. The creditworthiness of the borrower is a crucial barometer with which to assess whether the credit agreement can be entered into and, ultimately, the mortgage granted. In this respect, the tenor of the MCD is clear-cut:

‘Member States shall ensure that, before concluding a credit agreement, the creditor makes a thorough assessment of the consumers’ creditworthiness. The assessment shall take appropriate account of factors relevant to verifying the prospect of the consumer to meet his obligations under the credit agreement.’<sup>48</sup>

More specifically, the assessment of creditworthiness shall not ‘rely predominantly on the value of the residential immovable property exceeding the amount of the credit or the assumption that the residential immovable property will increase in value ...’<sup>49</sup>

The approach, in this respect, is expected to be revolutionary as it appears to thrust a ‘red card’ in the direction of previous practices. It is widely accepted that the 2008 financial crisis was also triggered to a degree by the property market bubble and the overly generous propensity of lenders to grant mortgages in the previous period by simply relying on the increasing value of the ‘underlying

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<sup>47</sup> A lucid example can be that of the British market of mortgages and the ‘PPI scandal’ (Policy Protection Insurance). A PPI is basically an insurance product which insures the repayment of the mortgage in case of major events affecting the borrower, such as death, illness or disability, or job loss. However, it was discovered in 2011 that this product had been sold to millions of UK borrowers, but the consumers were not informed of their existence or, if informed, they could not rely on the correct information about costs, and mechanism of functioning. See M Haentjens and P de Gioia-Carabellese, *European Banking and Financial Law* (Routledge 2015) 73.

<sup>48</sup> Article 18(1) of Directive 2014/17.

<sup>49</sup> Ibid., art 18(3).

asset' (the property).<sup>50</sup> Such an attitude means that any minimal decrease in the value of the property market, which is more than possible in the short-medium term, would render the borrower vulnerable. If forced to sell the asset during that period, he would find himself in negative equity, which means that what is he is required to repay to the bank for the loan, plus the lump sum he has advanced to buy the property, will exceed the actual value of the property.

Recital 55 seems to be particularly aware of this concern.

‘... Consequently, the possibility that the value of the immovable property could exceed the credit amount or could increase in the future should not generally be a sufficient condition for granting the credit in question. ...’

The only exception is the mortgage requested by the customer in order to construct or modernise an immovable property: in such a case, the value of the property can be the prevailing parameter of assessment.<sup>51</sup>

Similarly, the same Recital gives a mandate to each Member State ‘to issue additional guidance on those or additional criteria and on methods to assess a consumers’ creditworthiness’. Among these, specific mention can be made of loan-to-value limits and loan-to-income ratios. Needless to say, the Principles for Sound Residential Mortgage Underwriting Practices issued by the Financial Stability Board should be encapsulated within each Member State.<sup>52</sup>

Further legal provisions contained in the article 18 under discussion are the following: art 18(2) in force of which ‘the procedures and information on which the assessment is based are established documented and maintained’; article 18(4) which conversely sets forth the obligation, borne by the creditor, to ensure that once the credit agreement is concluded this contract is not altered or cancelled ‘on the grounds that the assessment of creditworthiness was incorrectly conducted’.

It can be said, therefore, that art 18 of Directive 2014/17, with hindsight, constitutes a ‘reprimand’ for much of the banking practices which spiralled out of control at the onset of the present millennium and where an assessment of the mortgage was superficially based on the value of the property to purchase (and the accompanying assumption that it would increase). Conversely, as from March 2017, the correct criterion to establish the feasibility of the mortgage shall be based primarily on the ability of the borrower to repay the instalments from his own income. The value of the property shall be a factor, but not the prevailing one.<sup>53</sup>

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<sup>50</sup> In the vest economic literature, see *inter alia* Y Demyanyk & O Van Hemert, ‘Understanding the Subprime Crisis’ (2011)24(6) The Review of Financial Studies 1848-1880; AV Thakor, ‘The Financial Crisis of 2007-2009: Why did It Happen and What did We Learn’ (2015)4 Review of Corporate Finance Studies (2) 155-205.

<sup>51</sup> Art 18(3) and Recital 55 of the Directive 2014/17.

<sup>52</sup> Directive 2014/17, Recital 55.

<sup>53</sup> M Haentjens and P de Gioia-Carabellese, *European Banking and Financial Law* (Routledge 2005) 72-73.

#### **5.4. Property evaluation; disclosure and verification of consumer information**

Chapter 6, headed ‘Creditworthiness Assessment’ is integrated with two additional legal provisions: the property evaluation; the disclosure and verification of consumer information.

##### **5.4.a. Property evaluation**

Article 19 of Directive 2014/17 stipulates that each country ensure that ‘reliable standards for the valuation of residential immovable property for mortgage lending purposes’ are developed. These standards shall be adhered to on a mandatory basis by creditors and the onus lies on each country to ensure that compliance with this rule is observed. In this respect, the role of the appraisers, either working within the structure of the bank or outside, is critical. Potentially, if not qualified, they could give rise to a new bubble by simply inflating the market value of the property. Thus, the requirement of the Directive under discussion is that the appraiser ‘can provide an impartial and objective valuation, which shall be documented in a durable medium and of which a record shall be kept by the creditor.’<sup>54</sup>

In this respect, one of the British jurisdictions, the Scottish one, may have unconsciously and involuntarily implemented this philosophy of the EU Directive well in advance of its recent implementation. In fact, in that jurisdiction there is a system (the home report) whereby, before a property is marketed, a home report should be drafted by a chartered surveyor. In the home report, there should be an indication of some significant elements, amongst which is the value of the property. This home report may be regarded to embody, *mutatis mutandis*, what Directive 2014/17 is asking any lender to do. Seemingly, Scotland shall not be required, on this specific aspect, to implement the Directive, as the function of the current home report adequately caters for the standards which the lender is required to comply with.

##### **5.4.b. Disclosure**

The disclosure and verification of consumer information, dealt with under art 29, brings to light a further issue: the proper consideration by the creditor of the documentation submitted by the borrower as evidence of his creditworthiness. This information, whether acquired from external sources or through internal channels, ‘shall be appropriately verified, including through reference to independently verifiable documentation when necessary’.<sup>55</sup> This obligation rests not simply on the creditor but also on the credit intermediaries or appointed representatives: the latter shall ‘submit the necessary information obtained from the consumer to the relevant creditor to enable the creditworthiness assessment to be carried out.’<sup>56</sup>

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<sup>54</sup> Directive 2014/17, art 19.

<sup>55</sup> Ibid., art 20.

<sup>56</sup> Ibid., art 20(2).

## **6. The advisory activity relating to residential property credit agreements**

The offer to a consumer of a credit agreement relating to a residential property may be the outcome of an advisory activity carried out by the same creditor, but also by the credit intermediary or the appointed representative. The advisory activity can be either preceded by the conclusion of a specific contract or carried out informally, in conjunction with the offer of the mortgage. In both cases, the consumer shall be informed of the existence of an advisory activity. The reason for this is to ensure that he will not accrue any unexpected costs. On such a ground, the legal provisions of Directive 2014/17 stipulate that the Member States, in their respective legislations, must demand that the ‘operators’ provide the consumer with some specific pieces of information. These essentially fall under two categories: (a) the possible fees that this advisory activity may engender;<sup>57</sup> (b) communication relating to the fact that the recommendation is given to the consumer ‘on considering only their own product range’ or also the products offered by non-tied credit intermediaries or appointed representatives of non-tied credit intermediaries.<sup>58</sup>

### **6.1. Foreign currency mortgages**

Foreign currency loans are a further area where Directive 2014/17 has outlined its binding principles. The credit agreement, the currency of which is a foreign one is risky, for two reasons. First, it engenders an asymmetry: the consumer lives in a country where the currency is different from that of the loan. As a result, he cannot predict the fluctuations of the currency of the contract, simply because it differs from the currency in operation where he lives. Second, currency fluctuates by definition; the consumer, potentially unaware of this, may stand to lose a considerable sum of money if his instalment was to be paid in a currency that, in the meantime, had increased against its value reflected in his own country. Foreign currency mortgages have assumed the mantle of a battle ground where litigators, on the one side the lenders’ lawyers and on the other side the borrowers’ advisors, have waged their legal wars.<sup>59</sup>

Directive 2014/17 is somehow the legacy of these skirmishes. Although the foreign currency agreement for purposes of the purchase of a residential property remains valid, the new legislation now requires that Member States adopt a more protective national framework. In detail, when the foreign currency is the currency of the contract, a specific right is conferred on the consumer: that is, ‘to convert the credit agreement into an alternative currency under specified conditions’. This replacement currency which the consumer can opt for is either ‘the currency in which the consumer primarily receives income or holds assets from which the credit is to be repaid, as indicated at the time the most recent creditworthiness assessment in relation to the credit agreement was made’<sup>60</sup> or

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<sup>57</sup> Ibid., art 22(2)(b).

<sup>58</sup> Ibid., art 22(2)(a).

<sup>59</sup> See, for instance, in Italy A Torrente and P Schlesinger, *Manuale di Diritto Privato* (22<sup>nd</sup> edn Giuffrè Editore, Milan 2015) 691-693.

<sup>60</sup> Art 23(2)(a) of the MCD.

‘the currency of the Member State in which the consumer either was resident at the time the credit agreement was concluded or is currently resident.’<sup>61</sup>

The first option (conversion of the currency of the contract into the currency where the consumer resides) is coupled with a corollary at the following paragraph 3: if the consumer exercised his right of conversion, the national legislation must ensure that ‘the exchange rate at which the conversion is carried out is the market exchange rate applicable on the day of application for conversion’. This is a norm safeguarding the consumer against arbitrary and discretionary creditors’ decisions. Nevertheless, the potentially innovative nature of the legal provision is softened, if not neutralised, by the *caveat* that the agreement can also stipulate otherwise.<sup>62</sup>

## **6.2.Variable rates mortgages**

The variable rates agreements represent a further area of possible exploitation which unscrupulous banks may employ in their favour and thus against consumers. The variable rate lends itself to possible manipulations by the lender, as recent controversies across Europe have demonstrated. Second, the variable rate is risky, as it may expose the position of the borrower if the fluctuation resulted in a substantial increase of the rate. With this in mind, the mission adopted by the new legislation seems to one of securing transparency. The indexes or references at which the borrowing rate is calculated shall be ‘clear, accessible, objective’.<sup>63</sup> Additionally, both the parties to the credit agreement and the authorities shall be able to verify it.<sup>64</sup>

In accordance with the same line of reasoning, the ‘historical records of indexes for calculating the borrowing rates are maintained either by the providers of these indexes or the creditors.’<sup>65</sup> This norm may be potentially extraordinary. Given this specific, express obligation and the way it is worded, in a scenario of judicial controversy between the borrower and the lender the lack of compliance with the relevant rules (therefore the absence of records in the archives of the bank) may give rise to a presumption: the lender did not apply the rate correctly, *ergo* the right of the borrower to claim damages. Similarly, the supervisory authority could infer from this absence a systematic failure of transparency vis-à-vis the customers of that bank, therefore a violation of prudential rules of conduct towards the clientele.<sup>66</sup> Needless to say, despite the harmonisation, the EU countries and, therefore, the legal systems existing in each of them would play a decisive role in how the rules will be implemented.

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<sup>61</sup> Art 23(2)(b) of Directive 2014/17.

<sup>62</sup> This is criticized among Scholars. See M Haentjens and P de Gioia-Carabellese, *European Banking and Financial Law* (Routledge 2005) 71-73. It looks like that the consumer receives the carrot, but the stick will immediately materialise behind it!

<sup>63</sup> Article 24(a) of the MCD.

<sup>64</sup> *Ibid.*, art 24(a).

<sup>65</sup> Art 24(b) of Directive 2014/17.

<sup>66</sup> For instance, in Britain, in this scenario the Prudential Regulation Authority should step up to the plate and fine the credit institution that has breached these mandatory rules.

## **7. The nature of the rights under Directive 2014/17**

It is a commonly accepted axiom that the consumer is perennially relegated to a position of vulnerability vis-à-vis his professional counterparty. Aware of this adage, the Mortgage Credit Directive warns of the imperative nature of the rights conferred on the consumer in force of the Directive. In this respect, the consumers will be unable to ‘waive the rights conferred on them by national law transposing’ the Directive 2014/17. Furthermore, the way in which the Directive is transposed shall be in such a way as to render unfeasible the possibility that the consumer may lose his protection, because of the way the ‘agreements are formulated’.<sup>67</sup> A possible practice that must be prohibited by the national legislation is that of permitting the integration of credit agreements, clearly falling within the scope of the MCD, in ‘credit agreements the character of which would make it possible to avoid the application of those measures.’ Such practices, clearly elusive and, therefore, prohibited for reasons of a public policy, could be easily detected by any national court. This, in cases where a legal claim was lodged, would be empowered to identify in a broader agreement the specific mortgage falling within the scope of the Directive and its possible inconsistencies.

## **8. The foreclosure of the secured property in case of default: the principles of civil proceeding: common law and civil law perspective.**

Reference has been made, in the Introduction, to the fact that repossession, in cases of default of a debt, is the natural consequence of the lack of fulfilment of the obligations of a loan secured by a mortgage. This concept of ‘repossession’ can be manifested in a very different way and with a significant shift in intensity, according to whether the default takes place in common law jurisdictions or in countries which operate under the realm of civil law. In common law countries, such as Britain, the system of enforcement of the mortgage is still permeated by neo-liberal values.<sup>68</sup> In essence, the mortgagee, in cases where the mortgagor was not in a position to honour his obligations, is entitled to immediately take possession of the secured property.<sup>69</sup> Conversely, this system would be unlawful in most civil law jurisdictions, where typically the creditor is simply entitled to ask for the sale, through the medium of public auction, of the secured heritable property. Thus, the mortgagee will retain the proceeds of the sale whereas the secured property will be in the hands of a third party, the party who proved successful in offering the highest price.

### **8.1. The derogation from the prohibition of agreement of forfeiture**

In civil law jurisdictions, such as Italy, a pure repossession would again adhere to the principle of the mandatory prohibition of the ‘*pactum commissorium*’. The latter is the agreement whereby the creditor and debtor agree that, in cases whether the secured obligations were not honoured, the ownership of the secured property will be automatically transferred to the creditor. In a number of civil

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<sup>67</sup> Article 41(b) of Directive 2014/17.

<sup>68</sup> See, more recently, from a law and economics perspective, S Nield, ‘Mortgage Market Review: ‘Hard-Wired Common Sense/’ 2015(38) Journal of Consumer Policy 139-159, particularly 156.

<sup>69</sup> Although a Court order is nonetheless required. See section 88 of the Law of Property Act 1925.



law jurisdictions, such as Italy, the agreement shall be regarded as null and void, irrespective of any legal provision to the contrary by the parties.<sup>70</sup> The rationale behind these entrenched legislative stances is that the borrower's other creditors would be defrauded as they are deprived of an asset that otherwise they would be entitled to claim.<sup>71</sup> In Italy, again, the possible invalidity of the agreement of forfeiture, in connection with specific commercial transactions such as the sale and lease back agreements, has been better defined and, to a certain extent, curtailed at judicial level. According to Italy's highest court, *Corte Suprema di Cassazione*,<sup>72</sup> these contracts are valid despite their potential overlap with the principle of prohibition of agreement of forfeiture. However, it is important to ascertain, from time to time, whether the contract contains elements and/or features that may show that in reality that sale has been put in place exclusively for purposes of a guarantee. If this was the case, the agreement would seek to circumvent the prohibition and, therefore, is rendered invalid, as it contravenes a mandatory rule.<sup>73</sup> Further elements that may potentially reveal symptoms of invalidity are: the existence of a creditor/debtor relationship between the bank, granting the credit, and the company selling the good; economic difficulties experienced by the companies selling the good; the disproportion existing between the value of the good and the consideration paid by the purchaser (the rentee in the sale and lease agreement).<sup>74</sup>

In focusing now specifically on the EU legislation under discussion, it is interesting to note that Directive 2014/17 contains a regime in force of which, as far as mortgages on residential properties are concerned, the agreement of forfeiture can be derogated. In this respect, the precept of art 28(4) shall be recalled:

‘Member states shall not prevent the parties to a credit agreement from expressly agreeing that return or transfer to the creditor of the security or proceeds from the sale of the security is sufficient to repay the credit.’

It should be observed that, from a historical point of view, the MCD does not mark a revolutionary chapter in the annals of private law. Just over a decade ago, the Collateral Directive<sup>75</sup> had already established a micro-regime of private foreclosure. The relevant rules, still applicable, empower the collateral taker, if this is agreed with the collateral provider,<sup>76</sup> to use the collateral and to dispose

<sup>70</sup> See, among the others, F Gazzoni, *Manuale di Diritto Privato* (ESI, Naples 2013) 661. At scholarly level, see more recently: G Busset, ‘Anche una Procura a Vendere può Violare il Divieto del Patto Commissorio? (Commento a Cass. Civ., III sez., 8.7.2014, n. 15486)’ (2015)31 *La Nuova Giurisprudenza Civile Commentata* 65-73; S Pagliantini, ‘I Misteri del Patto Commissorio, le Precomprensioni degli Interpreti e il Diritto Europeo della Dir. 2014/17/EU’ (2015)38 *Le Nuove Leggi Civili Commentate* 181-204; C De Menech, ‘Il Patto Marciano e gli Incerti Confini del Patto Commissorio’ [2015] *Contratti* 823-841.

<sup>71</sup> A Torrente and P Schlesinger, *Manuale di Diritto Privato* (22nd edn Giuffrè Editore, Milan 2015) 481-483; F Gazzoni, *Manuale di Diritto Privato* (ESI 2013) 662.

<sup>72</sup> See the *decisa* no 5438 of 14 March 2006 and no 5583 of 9 March 2011.

<sup>73</sup> Doctrinally, see A Luminoso, ‘Lease Back, Mercato e Divieto del Patto Commissorio’ (2000)27 *Giurisprudenza Commerciale* (2) 489-503.

<sup>74</sup> See again Italian Supreme Court no 5438 of 14 March 2006 and no 5583 of 9 March 2011.

<sup>75</sup> Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (OJ L 168/43).

<sup>76</sup> Article 12 of Directive 2002/47/EC.

of it, in order to enforce his credit. The area of application of this system is limited to transactions concluded between certain market participants, such as banks, central banks and financial institutions.<sup>77</sup> Furthermore, some formal requirements must be met, specifically that where the collateral taker shall possess the collateral.<sup>78</sup> Finally, the transactions concerned with the new discipline are either a title transfer financial collateral arrangement or a security financial collateral arrangement.<sup>79</sup>

In some civil law jurisdictions such as the Italian one, there are some isolated opinions<sup>80</sup> that this derogation, now permitted under legislation, is regarded as subject to a limit: the mortgage shall be ‘symmetric’. This expression may imply that, in jurisdictions where the agreement of forfeiture is prohibited,<sup>81</sup> the judge will be equipped with the capacity to dis-apply the legal provision of art 28(4) if evidence was provided that the lender/borrower relationship was asymmetric. This conclusion, which may sound nebulous from a common law perspective,<sup>82</sup> will most certainly be tested in the years to come by the judiciary. Ultimately, according to this interpretation, the borrower will be furnished with the tools to tackle any arbitrary use of this power that the recent Directive grants to the lender, on the grounds that a degree of asymmetry may be detectable in the contract.

## **8.2. Foreclosure of the secured property and protection of the consumer**

Coupled with art 28(4) is the legal provision, contained in the following art 28(5), where it is stipulated that, in circumstances where the ‘price obtained for the immovable property affects the amount owed by the consumer’, then ‘Member States shall have procedures or measures to enable the best efforts price for the foreclosed immovable property to be obtained.’

The precept is not entirely transparent in regard to the language utilised in the first part of art 28(5), particularly in its use of the expression ‘price obtained for the immovable property’. It is obvious that in a mortgage the heritable property is given by the borrower as a security. If the mortgagor does not keep up the repayment, then the mortgagee forecloses on the mortgage.

The specific proceedings have been thus far left to the discretion of each jurisdiction. Fundamentally, the consideration received as a result of the sale (either public or private) of the property is given to the mortgagee who will use the proceeds of the sale to repay the residual loan. An example may clarify this. There is a Euro 100.000 20 year loan for the purchase of a heritable property. The mortgagor, after 10 years, defaults on his debts. At that point the bank has already been the beneficiary of a succession of instalments and interest accrued over a 10 year period. However, for the recovery of the remainder, it sells the

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<sup>77</sup> Ibid., article 1(2).

<sup>78</sup> Ibid., article 1(5).

<sup>79</sup> Ibid., article 1(5).

<sup>80</sup> S Pagliantini, ‘I Misteri del Patto Commissorio, le Precomprensioni degli Interpreti e il Diritto Europeo della Dir. 2014/17/EU’ (2015) *Le Nuove Leggi Civili Commentate* 195.

<sup>81</sup> Again, Italy can be an example.

<sup>82</sup> This is inferable from the general principles of common law in Britain. See, among others, E McKendrick, *Contract Law* (11<sup>th</sup> edn Palgrave Macmillan, London 2015).

property and the proceeds of the sale would invariably be sufficient to repay the residual loan. Needless to say, if from the sale of the secured property the bank received a sum in excess of that of the residual loan, this is expected to be returned to the borrower.

The new EU piece of legislation aims to put in place a system whereby the proceedings existing in each EU country are reviewed and reassessed so as to ensure that the best price can be achieved through the enforcement process. It is obvious that the best price for the property is essential in order to safeguard the interests of the borrower. The higher the price resulting from the sale, the higher are the possibilities for the debtor to recover a sum of money.

If this is the goal of the novel legislation as regards this specific point, then each country is required to review its civil proceedings to ensure that its system is consistent with the underpinning philosophy of the new EU piece of legislation. Thus, article 28(5) of Directive 2014/17 constitutes a warning to the different EU countries.

### **8.2.a. England and Wales**

The recipients of this warning may be, first and foremost, common law jurisdictions such as the British one. In the UK, particularly in England and Wales, where the borrower traditionally benefits from a more limited protection, the same concept of pure repossession detailed at the beginning of the present Section 8 could constitute a violation of the new statutory terms.<sup>83</sup> The pure repossession and the entitlement given to the lender to simply claim the property and to sell it privately may raise more than a few eyebrows.<sup>84</sup> In this private mechanism of foreclosure of the secured property, the borrower would seem to play a decidedly passive role, as he is rendered helpless to the actions of the lender.<sup>85</sup>

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<sup>83</sup> More recently, among Scholars (L Whitehouse, 'The First Legal Mortgagor: a Consumer without Adequate Protection?' (2015) 38 Journal of Consumer Policy 161-180) emphasis is placed on the status of the mortgagor, arguing in favour of a shift from the private law conception of the mortgagor as 'landowner' to the public law conception of the mortgagor as 'consumer'. To a certain extent, this is achieved via the recent Directive 2014/17, although the Damocles' sword hanging on the head of this recent piece of legislation is the recent Brexit vote cast by the British electorate and, therefore, the possibility for Britain to get rid of any form of adequate protection of this category of consumer.

<sup>84</sup> A different view emerges from the reading of the British Government's report (British Government, Implementation of the EU Mortgage Credit Directive <<https://www.gov.uk/government/consultations/implementation-of-the-eu-mortgage-credit-directive/implementation-of-the-eu-mortgage-credit-directive#fn:1>> accessed on 18 July 2016) it is emphasised that the UK already relies on a robust regulatory regime the purposes of which is to protect consumers engaged in the first charge residential mortgage market. More specifically, according to this report (Ibid), under the Financial Services and Markets Act 2000 (FSMA), 'the independent regulator, the Financial Conduct Authority (FCA) has the authority to put in place, supervise and enforce a range of rules to ensure that firms act responsibly in their mortgage activities.' The view advocated in this contribution is, by contrast, that this protection of the UK mortgage credit consumer was very tenuous and based on obsolete rules. As a result, a new EU regulation was required.

<sup>85</sup> It is important to note that in England and Wales, the mortgagee, as a result of a charge secured on an immovable property, is entitled to a statutory right to sell the asset. In this respect, section 85(1) of the Law of Property Act 1925 stipulates:

'A mortgage of an estate in fee simple shall only be capable of being effected at law either by a demise for a term of years absolute, subject to a provision for cesser on redemption, or by a charge by deed

It is true that, in England and Wales, the mortgagee is not empowered to repossess the charged asset in a discretionary way. In this respect, section 103(2)(i) of the Law of Property Act 1925 hints at the fact that the mortgagee shall give the mortgagor a notice 'requiring payment of the mortgage money'. Additionally, the mortgagee shall not be entitled to repossess the property unless there is a default in the payment of the mortgage money, or of part thereof, for 'three months after such service'. Furthermore, a previous court order shall be given, before the charged asset is sold.<sup>86</sup> Coupled with this micro-system of protection of the mortgagor is the following section 105 where it is stipulated that the money received by the mortgagee, arising from the sale, after the payment of encumbrances relating to the charged asset, shall be paid 'to the person entitled to the mortgaged property', therefore the debtor. This latest rule, not totally clear, fundamentally means that the mortgagee is prevented from cherry-picking from the sale of the charged asset: any retention of money that exceeds what the mortgagee is entitled to receive, would breach such a norm.

Despite these legal provisions and practices, it is not so speculative to figure out a legislative reform in Britain so that the protection afforded to the mortgagor across the Channel is aligned across the three different British jurisdictions.<sup>87</sup> This should take into account the 'public' status of the mortgagor, recently conferred on the mortgagor by the EU legislative. Irrespective of the recent EU reform, the need for a more modern legal framework in this area is justified by the nine decades passed since the promulgation of the current legislation (the Law of Property Act 1925). Paradoxically, this auspice could now be jeopardised by the recent Brexit vote, although the lack of clarity about the UK status upon completion of the exit process may render a prognosis of this still too risky.

### 8.2.b. Civil law jurisdictions

Civil law jurisdictions may also fall foul of the indirect scrutiny of article 28(5). Although in these countries the mechanism of enforcement is public, therefore delegated to an external party (the judiciary), the position of the borrower and his expectations to be treated fairly could be seriously undermined. Countries such as Italy, for instance, where the civil proceedings aimed at the sale of the secured property may last years, may not exactly reflect a country offering protection to the borrower. If the sale of a property takes place years after the initial recovery of the good, both the conditions of the good<sup>88</sup> and the variations in the market conditions may have had a detrimental effect on the value achieved through the sale and, ultimately, may cause a significant loss to be sustained by

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expressed to be by way of legal mortgage: Provided that a first mortgagee shall have the same right to the possession of documents as if his security included the fee simple.'

<sup>86</sup> This is also spelled out by the British Government. See British Government, Repossession <<https://www.gov.uk/repossession/repossession-orders>> accessed 1<sup>st</sup> July 2016,

<sup>87</sup> For sake of completeness of analysis, reference can be made to the repossession of a tenancy and the possible violation of the European Convention on Human Rights: judicially, see *Manchester City Council v Pinnock* [2011] UKSC 6. Among Scholars, see S Nield and N Hopkins, 'Human Rights and Mortgage Repossession: beyond Property Law using Article 8' (2013)33 Legal Scholars 431-454.

<sup>88</sup> By definition, a property becomes obsolete and its value is eventually negatively affected, if it is not adequately maintained.

the borrower.<sup>89</sup> In light of this scenario, and taking into account the new art 28(4) of the MCD, it is possible to conclude that the *pactum marcianum*,<sup>90</sup> existing in some civil law jurisdictions such as the Italian one, would be valid. This is the agreement whereby the creditor, in cases where the debtor defaulted, is entitled to ask for the sale of the secured good (or property) albeit at a value that is decided by a third independent party. The *pactum marcianum*,<sup>91</sup> as an alternative form of the *pactum commissorium*, already regarded as valid in civil law jurisdictions,<sup>92</sup> could constitute a mechanism to embed in the national legislation in order to fully mirror and validly implement the underpinning philosophy of article 28(4) of the MCD.

Not dissimilar is the reasoning applicable to the second part of art 28(5). It is affirmed more specifically that, in circumstances where ‘after foreclosure proceedings outstanding debt remains’, then ‘Member States shall ensure that measures to facilitate repayment in order to protect consumers are put in place.’ The precept would appear to suggest that the borrower, who still owes the lender a sum of money despite the realisation of the secured property, cannot be asked to pay the entire amount. This would be a double-whammy for that borrower: he loses his property and then still faces having to immediately repay the entire amount of the possible residual debt to the lender.

The purpose of this precept is clearly to safeguard the interests of the consumer. Accordingly, a jurisdiction, in order to comply with this new EU precept, should cater for it within its own domestic legislation. The tenor of the language used by the EU legislature does not facilitate a prediction of what, specifically, each country is expected to do in order to protect the consumer in circumstances of this kind. It is possible to predict that, in implementing the Directive at national level, either the lender will be required to write-off, merely partly or completely, the residual debt or to renegotiate the sum of residual debt. In the second case, national rules consistent with the new legislation could provide that, in case of

<sup>89</sup> See, in the Italian literature, S Pagliantini, ‘I Misteri del Patto Commissorio, le Precomprensioni degli Interpreti e il Diritto Europeo della Dir. 2014/17/EU’ (2015) *Le Nuove Leggi Civili Commentate* 196.

<sup>90</sup> More recently, it is recollected doctrinally (C De Menech, ‘Il Patto Marciano e gli Incerti Confini del Divieto del Patto Commissorio’ [2015] *Contratti* 823-841) that it was the Emperor Constantine who, under the increasing influence of the Christianity in Rome, ruled the abolishment of the *Lex Commissoria*. Until then, this law had regarded the practice of the agreement under discussion as totally lawful. Emperor Constantine’s statements, in abolishing the law, are perentory: ‘*Quonian inter alias captiones proecipue commissoriae pignorum legis crescit asperitas, placet infirmari eam et in posterum eius memoriam aboleri*’ (C. 8, 34, 3).

<sup>91</sup> The name given to this practice is courtesy of the jurist Elius Macianus who, after the *Lex Commissoria* was repealed, coma up with a legal stratagem, in order to allow the creditor to retake possession of the secured property, albeit with better guarantees for the debtor. The genesis of what it would be called later *pactum marcianum* can be found in a statement of the Digest (D. 20, I, 16, 9):

‘*Potest ita fieri pignoris datio hypothecaeve, ut, si intra certum tempus non sit soluta pecunia, iure emptoris possideat rem iusto pretio tunc aestimandam; hoc enim casu videtur quodammodo condicionalis esse venditio. Et ita divus Severus et Antonius resciperunt*’. See more recently, in the Italian literature, C De Menech, ‘Il Patto Marciano e gli Incerti confini del Divieto del Patto Commissorio’ [2015] *Contratti* 823-841.

<sup>92</sup> In Italy, see Italian Supreme Court, no 5440 of 18 March 2015; no 1625 of 28 January 2015; no 10986 of 9 May 2013. Among Scholars, see more recently, A Torrente and P Schlesinger, *Manuale di Diritto Privato* (22<sup>nd</sup> edn Giuffrè Editore, Milan 2015) 483.

residual debt, the repayment shall occur no earlier than a specified point in time, depending on the sum of debt still owed.

### 8.2.c. Art 28(2) and 28(3)

Finally, art 28(2) and art 28(3) contains legal provisions which both relate to the charges that the borrower is usually required to pay by the lender, in connection with the residential property loan, in case of default.

The first precept stipulates:

‘Member States may require that, where the creditor is permitted to define and impose charges on the consumer arising from the default, those charges are no greater than is necessary to compensate the creditor for costs he has incurred as a result of the default.’<sup>93</sup>

The second one affirms:

‘Member States may allow creditors to impose additional charges on the consumer in the event of default. In that case Member states shall place a cap on those charges.’<sup>94</sup>

There is certainly an economic rationale behind the EU legislature prompting the insertion of these two norms in the EU legal system. Banks are accustomed to imposing charges in case of default of the mortgagor; in some cases, these charges go well beyond the actual damages suffered by the lender. The charges, plus the interest that the bank has already received as remuneration during the period of the loan,<sup>95</sup> may ultimately constitute an unfair advantage to the stronger party, in other words the lender. Furthermore, some jurisdictions, such as the English one, are quite lenient in dealing with these issues. They tend to turn a blind eye to what banks may do to the detriment of the consumer. Therefore, these practices have not yet given rise to any judicial objection.

As a result of these new principles, encompassed within Directive 2014/17, any Member State should ensure that these charges are commensurate with the actual cost that the credit institution has incurred as a result of the default. Any additional charge shall be null and void, as it stands in violation of a clear and precise rule of the novel directive. It is unclear whether the concept of charges, which the EU legislature refers to, includes a consideration of interest too; in this case, not only would art 28 be innovative, but also it would be a revolutionary norm in jurisdictions such as the English one, where banks are nonchalantly permitted, in case of default, to capitalise on the interest.<sup>96</sup>

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<sup>93</sup> Article 28(2) of the MCD.

<sup>94</sup> Ibid., art 28(3).

<sup>95</sup> Technically speaking, this is called amortisation period.

<sup>96</sup> See *Deutsche Bank und Disconto Gesellschaft v Banque des Marchands de Moscou* (1931) 4 LDAB 293 and, even more explicitly, *National Bank of Greece S.A. (Appellant) v Pinios Shipping Co. No 1 and Another Respondents* [1989] 3 WLR 1330.

At common law, the bank entitlement to ask for compound interest traditionally depends on the contract expressly stipulating such an interest. Among Scholars, see WP Ellingers, E Lomnicka and CVM Hare, *Ellinger's Modern Banking Law* (5th edn, OUP 2011) 762. More recently, see P de Gioia Carabellese, ‘Compound Interest and its Validity (or Invalidity) in the Bank-Customer Relationship: the State-of-the-Art of British Common Law Discussed by virtue of a Comparative Analysis’ (2016)5 Law and Economics Yearly Review (forthcoming).

Notwithstanding this, the charges connected with the default of the mortgagor cannot exceed a threshold that each country shall put in place. In other words, in each jurisdiction there is an obligation for the authority, through either regulation or legislation, to indicate for the mortgage the maximum amount of default charges that the credit institution can impose. This new regime may sound quite ‘ordinary’ for civil law jurisdictions.<sup>97</sup> However, in the case of common law jurisdictions, where traditionally banks tend to have unfettered discretionary power, the norm is of some significance.

## 9. Conclusion

The MCD has received a heterogeneous welcome across Europe. The comparatively warm reception demonstrated in countries such as Italy, for instance, contrasts markedly with the scepticism manifested in Britain.

After analysing the main legal provisions of the MCD, it is difficult to offer forth a single shred of evidence to support the view that one of the main policy objectives of the statute, the possibility to create a common market of the lenders operating in the mortgage sector will be achieved. The offer of mortgages is historically fragmented across the different countries and/or jurisdictions and the level playing field anticipated by Directive 2014/17 seems to be more wishful thinking, rather than evidence of a forthcoming reality.<sup>98</sup>

Yet, the new legal framework does bring something innovative and beneficial: the protection of the mortgage consumer, not simply as a consumer, but within an *ad hoc* philosophical categorisation. In this respect, the conduct that the credit institutions are required to comply with - the credit-worthiness based prevalently on the mortgage consumer’s ability to repay the mortgage rather than the expected rising value of the property - should banish the spectre of casino banking for good. The possibility that the consumer will ‘go bust’ should be rendered remote as the prospective mortgagor is now discouraged from taking up a loan exceeding his financial capacities. Although in the long term the property market can be viewed as profitable, in the short and middle term the overburdened finances of the borrower may prove fatal and force him into a no win situation if he was not in a position to maintain payment of the instalments.

A further benefit is for the same financial institutions and the expected principle of stability that they should comply with, also in order to mitigate systemic risks.<sup>99</sup> In this respect, the MCD could indirectly prevent credit institutions from engaging in risky pursuits: among these, the too nonchalant and superficial granting of mortgages to a willing horde of property buyers.

Actually, in better analysing the matter from this perspective, it can be affirmed that the MCD should have been even more persuasive. More in detail, as already

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<sup>97</sup> See, for instance, Italy.

<sup>98</sup> In this respect, the position of the British Government seems to be plausible.

<sup>99</sup> M Andenas and I H-Y Chiu, *The Foundations and Future of Financial Regulation* (Routledge, London and New York 2014).

alluded to under Section 2 above, art 5 of Directive 2014/17 could have more courageously required that the Member States, in cases where the national systems are based on a twin-peak supervision,<sup>100</sup> the authorities empowered to enforce the principles of Directive 2014/17 should have been both, *ergo* that in charge of the conduct of the intermediaries, and the one dedicated to their stability. According to this line of reasoning, Britain, where the powers under Directive 2014/17 have been conferred on the FCA (the authority exclusively in charge of overseeing the protection of the consumer), is still vulnerable as regards the consequences of reckless lending and the residual impact on the stability of the financial institution. Although it is arduous to say that across the Channel this may engender in future an infringement of the MCD as regards the way it has been implemented, nevertheless a more prudent approach would have been to give a mandate to two supervisory authorities in this area. Conversely, Italy is the jurisdiction where the Bank of Italy supervises both the conduct of the financial institutions and their stability. In this country, the authority upon which the powers under Directive 2014/17 have been conferred is the Bank of Italy. *Ergo*, this country may represent an example of ideal implementation of the MCD or, better yet, of perfect transposition of the principles of this recent EU piece of legislation.

Finally, from a purely private law perspective, Directive 2014/17 contains two remarkable novelties.

On the one hand, a new precept is enshrined in the laconic art 28(4): the possibility for the lender, so long as this is agreed in advance, to take possession of the secured property in the case of default. This new principle, accepted in its entirety in common law jurisdictions, is a significant departure from the prohibition of the agreement of forfeiture, existing and entrenched in civil law jurisdictions.<sup>101</sup> This derogation, further to the one already introduced under Directive 2002/47,<sup>102</sup> may be an opportunity to secure an alignment of these legal systems to the more modern principles of circulation of the security.

On the other hand, the MCD contains a ‘warning’ to the common law jurisdictions and their historical superficial acceptance of default charges. These conducts, so far tolerated under the common law but tackled with harshness under civil law jurisdictions, shall be unlawful, if these burdens exceeded the real cost that the bank is suffering. As highlighted under the previous Section 8, this power to detect the unlawfulness falls, seemingly, within the remit of the national courts, given the nature, clear and precise, of the new legal provision.

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<sup>100</sup> This is the case of Britain, where there is an authority in charge of the conduct of the intermediaries and a different one empowered to supervise the stability of the credit institution.

<sup>101</sup> Or, to cite the Italian jurisdiction, the *patto commissorio*.

<sup>102</sup> The so called ‘Collateralisation Directive’. For commentaries to this piece of legislation, see more recently M Haentjens and P de Gioia Carabellese, *European Banking and Financial Law* (Routledge, London and New York 2015) 209-226.